

**Supplemental Memorandum of Decision: 01-20182020R
Individual Income Tax
For the Year 2016**

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this written ruling.

HOLDING

Individual provided additional supporting documents establishing that she was entitled to additional refund of income tax because she documented that she moved from Indiana to Florida and changed her domicile to Florida; as such, her retirement income with respect to the 1099-R distribution was not subject to Indiana income tax because Individual was a Florida resident. Individual was also entitled to a refund of tax withheld on income from exercising her Stock Appreciation Rights, which was previously awarded by her former employer, because she documented that the income from exercising those Rights was not income derived from sources within Indiana subject to Indiana income tax. Individual, however, was not entitled to additional refund on her remaining W-2 income because her supporting documents could not be verified.

ISSUE

I. Individual Income Tax - Refund - Residency and Indiana Source Income.

Authority: 4 U.S.C. § 114; I.R.C. § 61; I.R.C. § 83; IC § 6-3-1-3.5; IC § 6-3-1-12; IC § 6-3-1-13; IC § 6-3-2-1; IC § 6-3-2-2; Treas. Reg. § 1.61-2; Treas. Reg. § 1.83-6; Treas. Reg. § 1.83-7; *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64 (Ind. 2009); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); [45 IAC 3.1-1-21](#); [45 IAC 3.1-1-22](#); [45 IAC 3.1-1-22.5](#); [45 IAC 3.1-1-23](#); Internal Revenue Service, *Publication 525, Taxable and Nontaxable Income* (2016); Internal Revenue Service, *Equity (Stock) - Based Compensation Audit Techniques Guide* (August 2015); U.S. MASTER TAX GUIDE § 1923 (CCH eds. 99th ed., 2016); Final Order Denying Refund 01-20181357 (August 10, 2018).

Taxpayer protests the denial of a refund claim.

STATEMENT OF FACTS

Taxpayer is an individual with a current Florida mailing address. In April 2017, Taxpayer filed an Indiana Part-Year or Full-Year Nonresident Individual Income Tax Return (Form IT-40PNR) for the tax year 2016. In that filing, Taxpayer claimed that she had no or zero (0) income subject to Indiana income tax and requested a full refund of \$35,465 withheld on her behalf. Upon review, the Indiana Department of Revenue ("Department") made adjustments to Taxpayer's filing and, by means of direct deposit, refunded Taxpayer \$23 on April 26, 2017.

In March 2018, Taxpayer filed a Form GA-110L, Claim for Refund (Claim Number 1839476), requesting that the Department refund her additional income tax, in the amount of approximately \$35,000. Taxpayer's refund claim was pertaining to "taxes paid in by her former employer." The Department, upon initial review, denied Taxpayer's claim in a letter dated April 27, 2018.

Taxpayer timely protested the refund denial, requesting that the Department make a "[f]inal determination without a hearing." The Final Order Denying Refund 01-20181357 (August 10, 2018), 20181031 Ind. Reg. 045180424NRA ("ODR"), was issued, denying Taxpayer's protest specifically based on the reason that, for 2016, Taxpayer was a full-year Indiana resident because Taxpayer failed to document that she effectively changed her domicile to Florida. As such, the ODR concluded that Taxpayer was domiciled in Indiana and was not entitled to the additional refund.

Taxpayer disagreed and submitted additional documents to support her rehearing request. The rehearing was conducted based on the additional documents submitted by Taxpayer. This Supplemental Memorandum of Decision ensues. Additional facts will be provided as necessary.

I. Individual Income Tax - Refund - Residency and Indiana Source Income.

DISCUSSION

In her Claim for Refund, Form GA-110L, Taxpayer stated that she "changed [her] residency to [Florida] in 2015 but [the Department] held her 2016 refund for taxes paid in by her former employer." The Department, based on documents provided, found that Taxpayer was a longtime Indiana resident and did not abandon her Indiana domicile. The Department thus concluded that, for 2016, Taxpayer was not entitled to the additional refund because Taxpayer was an Indiana domiciliary and was required to file an Indiana Full-Year Resident Individual Income Tax Return (Form IT-40), reporting and remitting her Indiana income tax on her income regardless of whatever source derived.

Taxpayer disagreed, requesting a rehearing. Throughout the rehearing process, Taxpayer offered additional documentation to support her position. Taxpayer asserted that she was entitled to the refund because (1) she changed her domicile and became a Florida resident; and (2) the income at issue was "stock options that were exercised after retirement" and therefore was not income derived from sources within Indiana subject to Indiana income tax.

Accordingly, the issue here is whether Taxpayer demonstrated that she was entitled to the refund of tax which Taxpayer's former employer withheld on her behalf because (1) prior to 2016, Taxpayer abandoned her Indiana domicile and became a Florida resident, and (2) the income she received was not income derived from sources within Indiana.

As explained previously in the ODR, Taxpayer is required to demonstrate that she was entitled to the claimed refund. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010).

Indiana imposes a tax "on the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC § 6-3-2-1(a). IC § 6-3-2-2(a) specifically outlines what is income derived from Indiana sources and subject to Indiana income tax. For Indiana income tax purposes, the presumption is that taxpayers file their federal income tax returns as required pursuant to the Internal Revenue Code. Thus, to efficiently and effectively compute what is considered the taxpayers' Indiana income tax, the Indiana statute refers to the Internal Revenue Code. IC § 6-3-1-3.5(a) provides the starting point to determine the taxpayers' taxable income and to calculate what would be their Indiana income tax after applying certain additions and subtractions to that starting point. In relevant part, the provision states "[i]n the case of all individuals, 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code), modified as follows" *Id.* Gross income includes all income whatever source derived. I.R.C. § 61(a).

A corporate employer may offer a stock option plan - qualified or otherwise (nonqualified or nonstatutory stock options) - to compensate its employees for services rendered. When such stock option is offered, it is compensation to employees and generally subject to income tax pursuant to Treas. Reg. § 1.61-2. Similarly, Indiana follows the federal tax law in taxing income from stock options. I.R.C. § 83(a) states in relevant part that if property is granted "in connection with the performance of services . . . the excess of the fair market value of such property . . . over the amount . . . paid for such property, shall be included in the gross income of the person who performed such services" When the corporate employer offers a nonqualified stock option to its employee, it may deduct the value of stock option for the tax year in which the option is included in the gross income of the employee. I.R.C. § 83(h); Treas. Reg. § 1.83-6(a). When the "employee exercises [the] nonqualified stock option, the employer is required to report the excess of the fair market value of the stock received over the amount that the employee paid for that stock on the employee's Form W2." U.S. Master Tax Guide § 1923 (CCH eds. 99th ed., 2016). Treas. Reg. § 1.83-7(a) further establishes requirements to determine the amount of the income to be included, which in relevant part, states "if the option has a readily ascertainable fair market value . . . [t]he person who performed such services realizes compensation upon such grant." *Id.* If the option does not have a readily ascertainable fair market value, income is realized when the option is exercised. *Id.* Regardless, the income from exercising stock options is subject to income tax.

Taxpayer in this instance argued that her W-2 income was not subject to Indiana income tax because (1) prior to 2016, Taxpayer abandoned her Indiana domicile and became a Florida resident, and (2) the income she received was not income derived from sources within Indiana. This Decision addresses Taxpayer's arguments, as follows:

A. Indiana Domicile.

As explained in the ODR, for Indiana income tax purposes, resident "includes (a) any individual who was

domiciled in this state during the taxable year, or (b) any individual who maintains a permanent place of residence in this state and spends more than one hundred eighty-three (183) days of the taxable year within this state . . . " IC § 6-3-1-12; see also [45 IAC 3.1-1-21](#). Nonresident is "any person who is not a resident of Indiana." IC § 6-3-1-13.

[45 IAC 3.1-1-23](#) explains further how "residency" affects a taxpayer's income tax liability, in relevant part, as follows:

(1) Taxpayer Moving to Indiana

When a taxpayer moves to Indiana and becomes a resident and/or domiciliary of Indiana during the taxable year, Indiana will not tax income from sources outside Indiana which the taxpayer received prior to becoming an Indiana domiciliary. Indiana will, however, assess adjusted gross income tax on all taxable income after the taxpayer becomes an Indiana resident.

(2) Taxpayer Moving from Indiana

Any person who, on or before the last day of the taxable year, changes his residence or domicile from Indiana to a place without Indiana, with the intent of abiding permanently without Indiana, is subject to adjusted gross income tax on all taxable income earned while an Indiana resident. Indiana will not tax income of a taxpayer who moves from Indiana and becomes an actual domiciliary of another state or country except that income received from Indiana sources will continue to be taxable . . .

In 2017, the Department revised the Adjusted Gross Income Tax regulations. Some revisions intended to clarify the definition of a person's domicile for Indiana income tax purposes and afford more considerations in determining a person's domicile. Thus, a taxpayer may benefit from the application of the new regulations when the taxpayer's domicile is in dispute. Thus, while this Decision applies the new regulations accordingly, this Decision also references and incorporates all relevant statutes, regulations, facts, and the Department findings discussed in the ODR and addresses Taxpayer's protest, in turn, as follows:

[45 IAC 3.1-1-22](#) (2017) states as follows:

(a) "Domicile" means a person's domicile is the state or other place in which a person intends to reside permanently or indefinitely and to return to whenever he or she leaves the place. **A person has only one (1) domicile at a given time even though that person may be statutorily a resident of more than one (1) state. A person is domiciled in Indiana if he or she intends to reside in Indiana permanently or indefinitely and to return to Indiana whenever he or she leaves the state.**

(b) A person is domiciled in a state or other place until such time as he or she voluntarily takes affirmative action to become domiciled in another place. **Once a person is domiciled in Indiana, that status is retained until such time as he or she voluntarily takes positive action to become domiciled in another state or country and abandons the Indiana domicile by relinquishing the rights and privileges of residency in Indiana.**

(c) **In order to establish a new domicile, the person must be physically present at a place, and must have the simultaneous intent of establishing a permanent place of residence at that place. The intent to change one's domicile must be present and fixed and not dependent upon the happening of some future or contingent event. It is not necessary that the person intend to remain there until death; however, if the person, at the time of moving to the new location, has definite plans to leave that new location, then no new domicile has been established.**

(d) There is no one (1) set of standards that will accurately indicate the person's intent in every relocation. The determination must be made on the totality of facts, supported by objective evidence, in each individual case.

(**Emphasis added**).

[45 IAC 3.1-1-22.5](#) (2017) further outlines the factors in determining a person's domicile, as follows:

(a) The Department may require documentation from a person to evaluate domicile.

(b) The one hundred eighty-three (183) day and permanent place of residence threshold in IC [§] 6-3-1-12(b) and [\[45 IAC 3.1-1-21\]](#) is not a test for domicile.

(c) **A person is presumed not to have abandoned their state of domicile and established a new state**

or other place of domicile in a given year if, during that year, the person maintained a permanent place of residence (whether as an owner, renter, or other occupier of the residence) in that state and the person did more than one of the following:

- (1) **Claimed a homestead credit or exemption** or a military tax exemption on a home in that state;
- (2) Voted in that state;
- (3) Occupied a permanent place of residence in that state or other place of domicile for more days of the taxable year than in any other single state;
- (4) Claimed a benefit on the federal income tax return based upon that state being the principal place of residence; or
- (5) Had a place of employment or business in that state.

A person may rebut this presumption through the presentation of substantial contrary evidence.

(d) If a person's domicile is not resolved by subsection (c), the Department may consider additional relevant factors to determine the person's state or other place of domicile, including the state or other place where the person:

- (1) **Maintained a driver's license or government issued identification card;**
- (2) **Was registered to vote;**
- (3) Registered a vehicle;
- (4) Claimed as dependents immediate family members who relied, in whole or in part, on the taxpayer for their support;
- (5) **Assigned or maintained a mailing address;**
- (6) Maintained bank accounts;
- (7) Maintained active membership in a religious, social, cultural or professional organization;
- (8) Received professional services; and
- (9) Kept valuables or family heirlooms.

This list of additional, relevant factors is not exclusive.

(Emphasis added).

Throughout the rehearing process, Taxpayer submitted additional documents to support her protest. Specifically, Taxpayer's supporting documentation demonstrated, among other things, that in late 2015 she moved to Florida, that she claimed the homestead exemption on her Florida home, that she registered to vote in Florida, and that she obtained a Florida driver's license. Taxpayer also took steps to relinquish the homestead exemption claimed on her Indiana home in 2016. Given the totality of the circumstances, the Department is prepared to agree that, for 2016, Taxpayer was not domiciled in Indiana because her supporting documentation overcomes the rebuttable presumption established under [45 IAC 3.1-1-22.5\(c\)](#).

As mentioned earlier, Taxpayer may also qualify as an Indiana resident if she spent more than 183 days during 2016 in Indiana when Taxpayer maintained a permanent place of residence in Indiana. IC § 6-3-1-12(b); [45 IAC 3.1-1-21](#). The ODR concluded that during 2016, Taxpayer did not spend more than 183 days in Indiana and thus was not a full-year Indiana resident under IC § 6-3-1-12(b). Nevertheless, it should be noted that, in this case, Taxpayer, who continues to maintain a permanent place of residence in Indiana, is on notice that for the purposes of determining Indiana residency, each year stands alone. *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64, 69 (Ind. 2009). Going forward, if similar circumstances arise again for different tax years, Taxpayer will be required to document her potential residency issues accordingly.

In short, the Department is prepared to agree that Taxpayer demonstrated that, for 2016, she was not a full-year Indiana resident under IC § 6-3-1-12.

B. Indiana Source Income.

As mentioned above, Indiana imposes a tax "on that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC § 6-3-2-1(a). IC § 6-3-2-2(a) specifically outlines what is income derived from Indiana sources and subject to Indiana income tax. In particular, with regards to nonresident persons, "adjusted gross income derived from sources within Indiana" . . . include . . . compensation for labor or services rendered within this state . . . " IC § 6-3-2-2(a)(4). When an individual only has retirement income, under 4 U.S.C. § 114(a), Indiana may only impose state income tax "on any retirement income of an individual who is [] a resident or domiciliary of [Indiana] (as determined under the laws of [Indiana])." 4 U.S.C. § 114(b)(1) further provides what is considered as retirement income.

Taxpayer's W-2 and 1099 statements in this instance demonstrated that Taxpayer listed her Indiana address as the address of the "Employee" or "Recipient" for the 2016 year. By doing so, Taxpayer expressly informed her employer that she resided in Indiana, to which the financial and tax documents were to be sent. Therefore, there is a rebuttable presumption that Taxpayer had income derived from sources within Indiana and that her income, W-2 or otherwise, was subject to Indiana income tax.

Throughout the protest process, Taxpayer's representative referenced Taxpayer's W-2 and 1099 statements, asserting that Taxpayer's "income [was] treated as Indiana source income when in fact it was Florida source income." Specifically, the representative stated that Taxpayer's "W-2 income was solely from stock options; she did not work in Indiana at all during tax year 2016." Presumably, Taxpayer argued that because she was not an Indiana resident (domiciliary) and did not work in Indiana, she was entitled to the refund of the tax withheld by her former employer concerning the W-2 income from exercising her stock options, an equity-based compensation, previously granted by her former employer.

Upon review, Taxpayer's supporting documentation demonstrated that she received two (2) separate W-2 statements from two different companies - Company C and Company P - which withheld Indiana tax, in the amount of \$28,282 and \$1,182.60, respectively. But Taxpayer only offered additional verifiable information on the former without doing the same for the latter. In particular, the former W-2 statement was pertaining to the stock appreciation rights ("SARs") previously awarded to Taxpayer, in 2008 and 2009, by her former employer through a "Long Term Incentive Plan" (the "Plan"). The Plan's Schedule of Terms explained that the SARs provide Taxpayer "with the right to the appreciation in the common stock" of her former employer "measured from the date of grant to the date of exercise." When the Plan's specified terms and conditions were satisfied, such as the vesting rule, Taxpayer - employed or otherwise - was allowed to exercise her vested SARs before her vested SARs expired. Thus, Taxpayer received compensation in connection with the performance of services and the income from exercising her vested SARs was subject to income tax. Taxpayer exercised her vested SARs in 2016, several years after she retired from working for her former employer.

The Internal Revenue Service ("IRS") in its *Publication 525, Taxable and Nontaxable Income*, provides, in relevant part:

Stock appreciation rights. Do not include a stock appreciation right granted by your employer in income **until you exercise (use) the right**. When you use the right, you are entitled to a cash payment equal to the fair market value of the corporation's stock on the date of use minus the fair market value on the date the right was granted. You include the cash payment in income in the year you use the right. **(Emphasis in original) (Emphasis added).**

Internal Revenue Service, *Publication 525, Taxable and Nontaxable Income* 4 (2016), available at <https://www.irs.gov/pub/irs-prior/p525--2016.pdf> (last visited December 26, 2018). IRS in its 2015 *Audit Techniques Guide* further explains, as follows:

Stock Appreciation Rights are another method of compensating employees or independent contractors. A Stock Appreciation Right (SAR) is an arrangement, during a specified period, which the employee has the right to receive the increased value of the employer's stock by cashing out or exercising the SAR. The employee can only benefit from the appreciation in the value of the stock; therefore, **a taxable event does not take place until the exercise of a SAR. The amount received upon exercise of the SAR is includible in the employee's income, constitutes wages, and creates a deduction to the employer at that time . . . Stock appreciation rights are NOT deferred compensation subject to the special timing rule under [I.R.C.] §3121(v)(2)**. See Treas. Reg. §31.3121(v)(2)-1(b)(4)(ii) and Notice 2005-1. **(Emphasis added).**

Internal Revenue Service, *Equity (Stock) - Based Compensation Audit Techniques Guide* (August 2015), available at <https://www.irs.gov/businesses/corporations/equity-stock-based-compensation-audit-techniques-guide> (last visited December 26, 2018).

Therefore, when Taxpayer exercised her vested SARs in 2016, even though Taxpayer was retired from her employment, Taxpayer's former employer properly withheld tax on the payment pertaining to Taxpayer's vested SARs and issued a W-2 statement accordingly pursuant to the IRS guidance above. When Taxpayer exercised her vested SARs in 2016, she had already moved from Indiana to Florida and established her domicile in Florida. Thus, when Taxpayer exercised her SARs - the taxable event - in 2016, Taxpayer was not an Indiana resident

(domiciliary) and did not work in Indiana. As such, Taxpayer's income from exercising her vested SARs was not derived from sources within Indiana subject to Indiana income tax pursuant to IC § 6-3-2-2(a)(4).

Taxpayer's documentation, however, failed to substantiate that the other W-2 statement issued by Company P was not income derived from sources within Indiana because her supporting documentation could not be verified. Thus, given the totality of the circumstances, in the absence of other verifiable supporting documents, the Department is not able to agree that Taxpayer was entitled to the refund of that \$1,182.60.

Finally, it should also be noted that since the Department concluded in Part A that, for 2016, Taxpayer was not an Indiana resident under IC § 6-3-1-12, Taxpayer's retirement income was therefore not subject to Indiana income tax pursuant to 4 U.S.C. § 114. In this instance, Taxpayer received a 1099-R (Code 7 in box 7) distribution and a tax of \$6,000 was withheld on that income. Taxpayer thus was entitled to a refund of the tax on that 1099-R distribution.

In short, Taxpayer's supporting documentation demonstrated that, for 2016, she was not an Indiana resident (domiciliary) under IC § 6-3-1-12. Thus, Taxpayer's retirement income, such as the 1099-R distribution, was not subject to Indiana income tax pursuant to 4 U.S.C. § 114(a). Additionally, Taxpayer's documents demonstrated that after she retired and became a Florida resident in 2016, she exercised her vested SARs, the taxable event. As a nonresident for Indiana income tax purposes, her W-2 income from exercising her vested SARs, which was previously granted to her, was not income derived from sources within Indiana under IC § 6-3-2-2(a)(4). However, as to the tax withheld on the remaining W-2 income she received from Company P, Taxpayer was not entitled to the refund because Taxpayer's documents cannot be verified. Thus, Taxpayer was required to report that income from Company P and remit the Indiana income tax accordingly.

FINDING

Taxpayer's protest is sustained in part and denied in part.

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